ORIGINAL

KELLOGG, HUBER, HANSEN, TODD & EVANS, P.L.L.C.

SUMNER SQUARE
1615 M STREET, N.W.
SUITE 400
WASHINGTON, D.C. 20036-3209

(202) 326-7900
FACSIMILE:
(202) 326-7999

MICHAEL K. KELLOGG
PETER W. HUBER
MARK C. HANSEN
K. CHRIS TODD
MARK L. EVANS
STEVEN F. BENZ
NEIL M. GORSUCH
GEOFFREY M. KLINEBERG
REID M. FIGEL

HENK BRANDS
SEAN A. LEV
EVAN T. LEO
ANTONIA M. APPS
MICHAEL J. GUZMAN
AARON M. PANNER
DAVID E. ROSS
SILVIJA A. STRIKIS
RICHARD H. STERN, OF COUNSEL

February 9, 2001

Rebecca A. Beynon, Esq.
Office of Commissioner Furchtgott-Roth
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Re: ***In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Inter-Carrier Compensation for ISP-Bound Traffic*, CC Docket Nos. 96-98, 99-68**

Dear Rebecca:

On behalf of Verizon, I enclose a memorandum entitled "Internet-Bound Traffic Is Not Subject to Reciprocal Compensation Under § 251(b)(5)," which fleshes out some of the thoughts we expressed in our meeting with you on January 30.

I also enclose, as you requested, a copy of a memorandum dated July 21, 2000 ("Analysis of Issues on Remand in Reciprocal Compensation Proceeding"), which Aaron Panner and I prepared, and which the United States Telecom Association attached to its comments in this proceeding.

We will file a copy of this letter and the enclosures with the Secretary as an ex parte submission.

Sincerely,

Mark L. Evans

INTERNET-BOUND TRAFFIC IS NOT SUBJECT TO RECIPROCAL COMPENSATION UNDER § 251(B)(5)

The Problem

1. The current reciprocal-compensation regime imposes a regulatory tax on the Internet. Carriers that interpose themselves between incumbent carriers and Internet service providers ("ISPs") act as toll collectors for the Internet. These carriers provide no real service and no added value, yet they skim off literally billions of dollars in subsidies for doing nothing more than allowing calls to the Internet to pass through their gates. This is now a billion dollar drain for Verizon alone, and is still growing. As one analyst aptly stated, "[e]veryone now understands that the structure of reciprocal compensation simply represents a wealth transfer from the RBOC to the CLEC."[1] Because ILEC shareholders cannot bear this uneconomic, purely regulatory cost indefinitely, they will be forced to raise their rates for local service. The existing regime will therefore have the inevitable (and economically perverse) consequence of imposing a secret tax — indeed, a highly regressive tax — on *all* local phone customers, regardless of their use of the Internet.

2. ISP reciprocal compensation discourages local competition. Reciprocal compensation paid on Internet-bound traffic discourages local competition in at least three ways: (1) It directs investment away from serving local competition to exploiting the arbitrage opportunity. (2) It converts residential customers from assets to potential reciprocal-

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[1] Daniel Ernst Legg Mason, *Biller Keeps All; FCC Expected to Set Zero Price Target for Reciprocal Comp* (Nov. 27, 2000).

compensation liabilities.[2] (3) It creates the perverse situation in which a residential customer is more valuable to a CLEC as a customer of the ILEC than as a customer of the CLEC.

3. Regulators caused this problem, and regulators should fix it. The FCC has permitted states to impose this requirement, even though the 1996 Act does not authorize it. And the FCC has had this policy issue before it for more than three years without taking definitive action. It is time for the FCC to rescue the 1996 Act regime from this regulatory morass.

The Solution

As Verizon has explained elsewhere, we believe the solution to this problem is to reconfirm that Internet-bound traffic is interstate and interexchange and therefore is not subject to § 251(b)(5), which applies only to traffic that both originates and terminates within the same local exchange area. This solution is fully compatible with the D.C. Circuit's remand decision, which requires the FCC only to bolster the explanation for its previous conclusion to this effect. The FCC, exercising its § 201 authority over interstate communications, would then adopt a regime under which inter-carrier compensation is not owed for Internet-bound traffic.

Other parties, in contrast, have argued that a call to the Internet should be classified not as a single interstate call but rather as two separate calls — the first consisting of the connection to the ISP and the second consisting of the connection to a distant Web site. As we previously have explained at some length, we believe this theory conflicts with decades of FCC precedent and with the technical realities of the way Internet communications work. But even assuming it were

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[2] *See* Scott C. Cleland, The Precursor Group/Legg Mason Research Technology Team, *Reciprocal Compensation for Internet Traffic — Gravy Train Running Out of Track* (June 24, 1998).

correct, Internet-bound traffic still would not fall within the scope of § 251(b)(5)'s obligation to enter into reciprocal-compensation arrangements. On the contrary, Internet-bound traffic is entirely one-way and is in no sense reciprocal. It is inconceivable that the 1996 Congress intended to create a massive new uneconomic subsidy flow by requiring the payment of reciprocal compensation on the manifestly *non*-reciprocal flow of traffic to the Internet.

1. Reciprocal compensation under the 1996 Act does not apply to exclusively one-way traffic flows. Under § 251(b)(5), a LEC must "establish *reciprocal* compensation arrangements for the transport and termination of telecommunications." Reciprocal-compensation arrangements comply with the 1996 Act only if they provide for "the *mutual and reciprocal* recovery by each carrier of costs associated with the transport and termination on each carrier's network facilities of calls that originate on the network facilities of the other carrier." 47 U.S.C. § 252(d)(2)(A)(i) (emphasis added).

The dictionary meaning of the word "reciprocal" is unambiguous: "corresponding, matching, equivalent"; "given or felt by each toward the other." Random House Webster's College Dictionary at 1125 (1995). The meaning of "mutual" is equally clear: "possessed, experienced, performed, etc., by each of two or more with respect to the other." *Id.* at 893.

By its language and structure, therefore, the 1996 Act makes clear that the reciprocal-compensation obligation applies only in situations where competing LECs within the same local exchange area terminate traffic originated on each others' networks.

2. Internet-bound traffic is intrinsically one-way, not reciprocal. Regardless of whether Internet-bound calls are viewed as terminating locally or as continuing beyond the local exchange area to distant Web sites, it is entirely clear that, as currently configured, Internet-bound traffic by its very nature is exclusively one-way. The end-user always initiates the call that

establishes the circuit-switched connection between the end user and the ISP, and the ISP *never* originates calls to end-users on the network. There can be no "mutual and reciprocal recovery of costs" with respect to such inherently one-way traffic. The traffic therefore cannot sensibly be subject to the reciprocal-compensation obligation established by § 251(b)(5).

The technical nature of Internet communications distinguishes this traffic from other types of communications. In the case of a dial-up call to the Internet, the communication originates when a customer uses a computer modem to connect to an ISP. The customer then designates the desired Web site by typing an address designator or "URL" into the browser, and a router at the ISP's location directs the communication over the Internet to its destination. The Web site then processes the customer's request and initiates a separate communication to send the requested information back to the customer's address, typically over a different Internet pathway. But because a portion of the communication travels from the ISP to the customer over the connection initially established by the customer, the entire communication has been treated as part of a call originated by the customer to reach the Internet. CLECs have exploited the unique technical configuration of Internet communications to argue that they are entitled to reciprocal compensation for each and every minute that the connection is in place, regardless of the direction of the information flow.

3. Internet-bound calls make up a discrete class of communications traffic.

Internet-bound traffic is a unique category of telecommunications. The FCC may and should treat it as a distinct class of traffic for purposes of applying § 251(b)(5).

For example, Internet traffic differs fundamentally as a technical matter from traditional wireline telephone traffic. The originating party in a traditional wireline service can differ from call to call. Thus, if a CLEC serves one party and an ILEC another, either the CLEC's customer

or the ILEC's customer may originate any given call. This stands in sharp contrast to Internet calls, where the ISP never originates the call. A CLEC serving an ISP will never be the originating carrier.

Similarly, wireless calls can go in both directions, and the technology does not dictate who will be the called party. They too, therefore, differ significantly from one-way Internet calls. In ruling that the traffic received by paging carriers, though usually one-way, is nonetheless subject to reciprocal compensation, the Commission, without directly addressing the one-way nature of the traffic, justified its decision by treating paging traffic as a subset of CMRS traffic.[3] Even then it made clear that paging traffic should be compensated at a lower rate.[4] In any event, paging traffic is fundamentally different from Internet traffic from a technical standpoint. Unlike Internet calls, the paged party does not initiate a return call to deliver large amounts of information over a connection established by the party initiating the page. Regardless of whether the FCC was right to lump paging traffic together with the much larger volume of two-way CMRS traffic, the paging precedent could not possibly justify treating one-way Internet-bound traffic as a subset of two-way voice traffic.

4. Under this interpretation, Internet-bound traffic remains generally subject to § 251 even though it is not subject to reciprocal compensation under § 251(b)(5). That

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[3] See First Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499, 15997, ¶ 1008 ("*Local Competition Order*"), *modified on recon.*, 11 FCC Rcd 13042 (1996), *vacated in part, Iowa Utils. Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997), *aff'd in part, rev'd in part sub nom. AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366 (1999), *decision on remand, Iowa Utils. Bd. v. FCC*, 219 F.3d 744 (8th Cir. 2000), *cert. granted*, Nos. 00-511 *et al.* (Jan. 22, 2001).

[4] *See id.* at 16043, ¶ 1092.

Internet-bound calls do not qualify for reciprocal compensation under § 251(b)(5) does not necessarily mean that such traffic is altogether outside the scope of § 251. Regardless of whether Internet-bound calls are deemed to qualify as telephone exchange service or exchange access,[5] carriers still have an obligation to interconnect in order to exchange this traffic under § 251(a)(1). The solution we propose, therefore, does not entail creating a category of traffic outside the scope of the Act. Rather, it recognizes that the Act's requirement to enter into "reciprocal" compensation arrangements does not apply to this unique category of inherently *non*-reciprocal traffic.

5. An interpretation that excludes Internet-bound traffic from a LEC's reciprocal-compensation duty would not be difficult to administer. If the FCC were to rule that Internet-bound traffic is not subject to reciprocal compensation under § 251(b)(5) because it is intrinsically one-way and therefore non-reciprocal, the Commission could easily devise a mechanism for state commissions to use in determining whether a particular CLEC is entitled to reciprocal compensation. One model that seems particularly suited to this purpose is the burden-shifting presumption adopted by the Massachusetts Department of Telecommunications and Energy. That agency required Verizon to pay reciprocal compensation so long as the ratio of payments to a CLEC does not exceed 2:1 — that is, so long as the CLEC does not terminate more than twice as much traffic as it originates.[6] As the DTE explained: "In the current absence

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[5] *See* Order on Remand, *Deployment of Wireline Services Offering Advanced Telecommunications Capability*, 15 FCC Rcd 385, 411-13 (1999) (Statement of Commissioner Harold Furchtgott-Roth Approving in Part & Dissenting in Part).

[6] Order, *Complaint of MCI WorldCom, Inc. Against New England Telephone and Telegraph Company d/b/a Bell Atlantic-Massachusetts for Breach of Interconnection Terms*

of a precise means to separate ISP-bound traffic from other traffic, we believe that Bell Atlantic's 2:1 ratio as a proxy is generous to the point of likely including some ISP-bound traffic. However, this 2:1 proxy is rather like a rebuttable presumption, allowing any carrier to . . . adduce evidence in negotiations, or ultimately arbitration, that its terminating traffic is not ISP-bound, even if it is in excess of the 2:1 proxy."[7]

Under the Massachusetts approach, the state commission would be expected to require the payment of reciprocal compensation where the traffic imbalance is no greater than 2:1, but would presume that the traffic is Internet-bound (and therefore not subject to reciprocal compensation) where the traffic balance exceeds that ratio. A CLEC would nonetheless remain free to demonstrate that, despite an imbalance greater than 2:1, the traffic at issue is in fact not destined for the Internet, in which case reciprocal compensation would continue to be payable.

6. This approach properly preserves the role of state commissions. The approach we propose reflects a proper allocation of authority between the FCC and the state commissions, one that is entirely consistent with both the statute and the Supreme Court's decision in *Iowa Utilities Board*. The FCC itself should resolve by rulemaking the threshold interpretive issue — whether ILECs must pay reciprocal compensation under § 251(b)(5) for a class of inherently non-reciprocal traffic. The Supreme Court has made clear that the FCC has plenary authority under 47 U.S.C. § 201(b) to adopt rules interpreting the provisions of the 1996 Act, and it would make

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Entered Into Under Sections 251 and 252 of the Telecommunications Act of 1996, DTE 97-116-C, at 28 (Mass. D.T.E. May 19, 1999) (available at <http://www.state.ma.us/dpu/telecom/97-116-c/97-116-c.htm>).

[7] *Id.* at 28 n.31.

little sense in this context to expect the state commissions individually to decide — possibly in conflicting ways — whether reciprocal compensation is required for one-way traffic bound for the Internet. Once the FCC determines that reciprocal compensation is not required for such traffic, and once it establishes a methodology for states to resolve whether the traffic at issue is in fact one-way Internet traffic, its role is completed. It is then left to the state commissions to implement that uniform interpretation and to apply that methodology to resolve arbitration disputes. That allocation of authority directly parallels the Supreme Court's view of the proper division of responsibility under the 1996 Act.[8]

That is not the only role that state commissions would have under this approach. Parties would of course remain free voluntarily to agree to pay reciprocal compensation for Internet-bound traffic, perhaps in return for other concessions from their negotiating partners. And some LECs may already have made such commitments in approved agreements that contain no change-of-law provisions. In both such circumstances, the state commissions would remain responsible for interpreting and enforcing those agreements.

February 9, 2001

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[8] As the Court explained in the context of pricing authority: "The FCC's prescription, through rulemaking, of a requisite pricing methodology no more prevents the States from establishing rates than do the statutory 'Pricing standards' set forth in § 252(d). It is the States that will apply those standards and implement that methodology, determining the concrete results in particular circumstances." *AT&T Corp. v. Iowa Utils. Bd.*, 119 S. Ct. 721, 732 (1999).

ANALYSIS OF ISSUES ON REMAND IN ISP RECIPROCAL COMPENSATION PROCEEDING

Mark L. Evans
Aaron M. Panner
Kellogg, Huber, Hansen, Todd & Evans, P.L.L.C.

Summary

Prior FCC precedent compels the conclusion that an Internet-bound call to an Internet Service Provider ("ISP") is non-local traffic that is not subject to reciprocal compensation under section 251(b)(5). That precedent remains correct, and nothing in *Bell Atlantic Telephone Cos. v. FCC*, 206 F.3d 1 (D.C. Cir. 2000), bars the Commission from reaffirming the conclusion that necessarily follows.

In vacating the *ISP Declaratory Ruling*,[1] the court expressed two principal concerns. First, the Commission had failed, in the court's view, adequately to explain why prior decisions adopting an end-to-end analysis to determine the jurisdictional nature of communications should govern whether the traffic is local for reciprocal-compensation purposes. Second, the court was not satisfied with the Commission's response to MCI's argument that, because ISP-bound traffic does not fit the statute's definition of "exchange access," it can only be "telephone exchange service" and therefore is necessarily subject to reciprocal compensation under section 251(b)(5).

To address the Court's concerns, the FCC should reaffirm its prior decision and make three fundamental points:

First, interpreting the terms of its own regulations implementing section 251(b)(5), the FCC should reconfirm that an Internet-bound call to an ISP is not local telecommunications traffic, and therefore is not subject to reciprocal compensation, because it does not originate and terminate within a single local calling area. Instead, an Internet-bound call involves a single continuous communication between the calling party and Internet sites that may be located across the country and around the world. Such calls are predominantly interexchange and interstate in nature.

Second, the FCC should explain that this straightforward application of its regulations makes sense in light of the Commission's prior decisions. The Commission has consistently applied its end-to-end analysis to the type of traffic at issue here to

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[1] Declaratory Ruling in CC Docket No. 96-98 and Notice of Proposed Rulemaking in CC Docket No. 99-68, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 14 FCC Rcd 3689 (1999).

resolve both jurisdictional and substantive questions concerning application of the Commission's rules. Just as important, the FCC's long-standing enhanced-service-provider ("ESP") exemption supports the decision to treat ISP-bound traffic differently from local traffic. Although enhanced service providers are permitted to purchase their links to the PSTN through state end-user tariffs, they are nonetheless users of interstate access. Accordingly, when an incumbent's customer calls an ISP served by a CLEC, the two carriers are involved in the joint provision of access, and the rationale for subjecting the call to reciprocal compensation does not apply. Indeed, application of the local-call model to Internet-bound calls leads to serious market distortions.

Third, the FCC should explain that whether Internet-bound calls constitute "telephone exchange service" is irrelevant to the determination of whether reciprocal compensation is due on such traffic — that question is governed by the fact that Internet-bound calls are not local within the meaning of the Commission's regulations. In any event, the Commission's prior determination that Internet-bound traffic is not "telephone exchange service" is correct and fully consistent with the determination that no reciprocal compensation is due on this traffic.

Discussion

I. Under the FCC's Rules, Internet-Bound Traffic Is Not Subject to Reciprocal Compensation

In its *Local Interconnection Order*,[2] the FCC determined that "reciprocal compensation for transport and termination of calls [under 47 U.S.C. § 251(b)(5)] is intended for a situation in which two carriers collaborate to complete a *local* call." 11 FCC Rcd at 16013, ¶ 1034 (emphasis added). Accordingly, the Commission held that "section 251(b)(5) reciprocal compensation obligations should apply only to traffic that originates and terminates within a local area," and that such obligations "do not apply to the transport or termination of interstate or intrastate interexchange traffic." *Id.* That determination was not only correct; it was the only reading of section 251(b)(5) that is consistent with the 1996 Act, and no one challenges it in this proceeding. That determination was codified in the requirement that LECs "establish reciprocal compensation arrangements for transport and termination of *local telecommunications traffic* with any requesting telecommunications carrier." 47 C.F.R. § 51.703(a) (emphasis added). The regulations defined "local telecommunications traffic" as "traffic . . . that originates and terminates within a local service area." *Id.* § 51.701(b)(1).

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[2] First Report and Order, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, 11 FCC Rcd 15499 (1996).

There is no question that Internet-bound traffic "originates" at the calling party's premises; the determinative question for the agency on remand, therefore, is where this traffic "terminates." As the D.C. Circuit's opinion makes clear, the Commission should answer that question in light of the agency's definition of "termination," which states: "For purposes of this subpart, termination is the switching of local telecommunications traffic at the terminating carrier's end office switch, or equivalent facility, and delivery of such traffic to the called party's premises." *Id.* § 51.701(d); *see Bell Atlantic*, 206 F.3d at 6.

In light of this definition, the communications at issue in this proceeding generally do not terminate within the local service area where they originate. When an ISP subscriber initiates a dial-up call to the Internet, the subscriber's computer modem dials an ISP access number to reach the subscriber's ISP. The telephone company routes the call to the telephone number assigned to the ISP; the ISP connects the call to the ISP's modem and router. Crucially, however, the call does not terminate there. Instead, after the ISP's modem "handshakes" with the subscriber's modem, the ISP converts the call to a Point-to-Point protocol and connects the end user to the ISP's authentication server. After the ISP's authentication server verifies the end user's logon and password, the ISP assigns the end user a temporary Internet address and connects the end user's computer to the ISP's web server. These servers can be located at any site on the World Wide Web.

The ISP's web server then permits the subscriber to send and receive information over the Internet to locations throughout the world. For example, the subscriber's browser may designate a preprogrammed "home page," which would be transmitted to the subscriber's computer when the subscriber begins the session on the Internet. The subscriber can then communicate with other websites by typing a Uniform Resource Locator (URL) address into an Internet browser. The requested URL address is sent to the ISP's Domain Name Server and is translated into a twelve-digit Internet Protocol address. The ISP's router then locates the requested website; the site's web server in turn sends the requested information to the subscriber's computer. Alternatively, the subscriber may send an e-mail message over the Internet to a recipient of the subscriber's choosing.

This process is analogous to the way interexchange carriers ("IXCs") provide long-distance telephone service using Feature Group A. In that circumstance, the end user likewise dials a seven- or ten-digit access number and is connected to an IXC. The IXC responds to the end user generally by requesting a Personal Identification Number. Once authorization is accomplished, the IXC returns a second dial tone to the end user. The end user then enters the telephone number of the distant end user, and the call is connected. In that situation, it makes little sense to say that the end user "calls" the IXC

or that the call "terminates" at the IXC; rather, the end user *uses* the IXC to call the distant end user. Despite the appearance of a locally dialed number, and the additional interaction between the caller and the IXC, there is no dispute that this is a single call that terminates only when it reaches its ultimate destination.

It is true, as the court observed (*see Bell Atlantic*, 206 F.3d at 7), that an Internet-bound call involves both telecommunications and information service, while a Feature Group A call may not. But the FCC has always held that this is a distinction without a difference when it comes to determining the end-points of communications. As the Commission explained:

> Among the variety of users of access service are facilities-based carriers, resellers (who use facilities provided by others), sharers, privately owned systems, *enhanced service providers*, and other private line and WATS customers, large and small, who "leak" traffic into the exchange. *In each case the user obtains local exchange services or facilities which are used, in part or in whole, for the purpose of completing interstate calls which transit its location and, commonly, another location in the exchange area.*

Memorandum Opinion and Order, *MTS and WATS Market Structure*, 97 F.C.C.2d 682, 711, ¶ 78 (1983) (emphasis added). The Commission has thus long recognized that calls to ESPs' locations do not terminate there but "transit" those locations to their ultimate destination for "complet[ion]." *Id.* Indeed, the Commission recognized that an ESP "might *terminate* few calls at its own location and thus would make relatively heavy interstate use of local exchange services and facilities." *Id.* at 712, ¶ 78 (emphasis added). The Commission has repeatedly confirmed this analysis in the past 15 years:

- ESPs "like facilities-based interexchange carriers and resellers, use the local network to provide interstate services." Notice of Proposed Rulemaking, *Amendments of Part 69 of the Commission's Rules Relating to Enhanced Service Providers*, 2 FCC Rcd 4305, 4306, ¶ 7 (1987);

- ESPs are "providers of interstate service[]" and "exchange access users." Order, *Amendments of Part 69 of the Commission's Rules Relating to Enhanced Service Providers*, 3 FCC Rcd 2631, 2631, ¶ 2 (1988);

- ISPs "may use incumbent LEC facilities to originate and terminate interstate calls." First Report and Order, *Access Charge Reform*, 12

FCC Rcd 15982, 16131-32, ¶ 341 (1997) ("*Access Charge Reform Order*");

- Internet-bound calls "do not terminate at the ISP[] . . . but continue to the ultimate destination or destinations, very often at a distant Internet website accessed by the end user." Memorandum Opinion and Order, *GTE Tel. Operating Cos.; GTOC Tariff No. 1; GTOC Transmittal No. 1148*, 13 FCC Rcd 22466, 22476, ¶ 19 (1998) ("*GTE Tariff Order*").

In this regard, the Commission should correct a mis-impression left by its brief before the D.C. Circuit. There, the Commission wrote that "[e]ven if, from the perspective of the end user as customer, the telecommunications portion of an Internet call 'terminates' at the ISP's server (and information service begins), the remaining portion of the call would continue to constitute telecommunications from the perspective of the ISP as customer." *Bell Atlantic*, 206 F.3d at 7 (quoting FCC Br. at 41). The court understood the FCC to be arguing that "the ISP *originates further telecommunications*." *Id.* (emphasis added); *see also id.* at 5 (calls to ISPs are "not quite long-distance, because the *subsequent communication* is not really a continuation, in the conventional sense, of the initial call to the ISP") (emphasis added). In fact, as the Commission's prior decisions make clear, there is no doubt that a call to an Internet website *is* a single, continuous communication.

That multiple providers of telecommunications service jointly carry the single telecommunication between the end user and, for example, a distant websites does not alter the fact that the stream of information is continuous. To be sure, part of the data transport is over the local exchange network, and part of the data transport is over interexchange facilities. But the same is true in the case of most long-distance calls made by ILEC customers, regardless of whether an information service rides on top of them. *Cf. AT&T Corp. v. City of Portland*, No. 99-35609, 2000 WL 796708, at *8 (9th Cir. June 22, 2000) ("The Internet's protocols themselves manifest a related principle called 'end-to-end': control lies at the ends of the network where the users are, leaving a simple network that is neutral with respect to the data it transmits, like any common carrier.").

The *BellSouth Voice Mail Case*[3] provides another illustration of the principle that the point of termination of any communication — whether a basic telecommunications service or an enhanced service — must be determined by reference to its actual end-

[3] Memorandum Opinion and Order, *Petition for Emergency Relief and Declaratory Ruling Filed by BellSouth Corp.*, 7 FCC Rcd 1619 (1992).

points, without regard to intermediate switching points. The Commission there rejected the same argument that its end-to-end jurisdiction over interstate communications can be defeated by dividing the communication into a call to "the intended recipient's location" and a purely intrastate communication "forwarding the call to the voice mail apparatus and service." *Id.* at 1620, ¶ 8. Instead, the Commission found that, "[w]hen the caller [to voice mail service] is out-of-state, there is a continuous path of communications across state lines between the caller and the voice mail service, just as there is when a traditional out-of-state long distance voice telephone call is forwarded by the local switch to another location in the state." *Id.* at 1620, ¶ 9. Similarly here, there is a continuous path of communications between the end user and the distant Internet site. Because the D.C. Circuit apparently did not appreciate the significance of the *BellSouth Voice Mail Case*, the Commission on remand should demonstrate its importance with care.

To cement this analysis, the Commission should explain that nothing in the *Access Charge Reform Order* calls these points into question. In particular, the D.C. Circuit was troubled by the statement in its *Access Charge Reform Order* that "it is not clear that ISPs use the public switched network in a manner analogous to IXCs" (12 FCC Rcd at 16133, ¶ 345). *Bell Atlantic*, 206 F.3d at 8. Of course, that statement, by its terms, announces no determination at all — it *raises* a question; it does not resolve the question. Moreover, the Commission raised the question only in the context of whether ISPs should be required to pay per-minute access charges, not in the context of whether ISP-bound traffic is subject to federal reciprocal-compensation obligations. Accordingly, the Commission should now make clear that, for purposes of inter-carrier compensation, ISPs *do* use the public-switched network in a manner analogous to IXCs, that ISP customers (like IXC customers) use the local network to originate an interexchange transmission of information, and that the exemption of ISPs from per-minute access charges is a function solely of policies unrelated to the manner in which they use the local network. Indeed, the Commission has made clear for over 15 years that ISPs use local exchange facilities in the provision of interstate information services — that is, for calls that terminate outside of the local calling area in which they originate.[4] The Commission should reaffirm those prior holdings here.

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[4] The D.C. Circuit made much of a footnote in the *Access Charge Reform Order* in which the Commission stated that "[t]o maximize the number of subscribers that can reach them through a *local* call, most ISPs have deployed points of presence." 12 FCC Rcd at 16132, n.502 (emphasis added). Read in the context of the order, however, this statement plainly refers to the status of the calls for *billing* purposes, nothing else. Any other reading renders the substantive holding of the *Access Charge Reform Order* nonsensical: if calls to ISPs were local, the issue of application of access charges to such calls simply would not arise. Indeed, there would be no need to have an "exemption" from access charges unless those charges would otherwise apply.

The Commission should also make clear that the "called party" for purposes of the Commission's rule is not the ISP, but the ultimate Internet destination designated by the subscriber — just as the called party in the case of a Feature Group A call is not the IXC, but the party designated by the subscriber. Nothing in the D.C. Circuit's opinion forecloses this conclusion, which is the only determination consistent with the nature of the communications at issue. An additional illustration of this point is the example of Internet "chat rooms," where subscribers are able to interact in real time with other subscribers. The suggestion that the ISP is the "called party" in such circumstances, or that such a call "terminates" at the ISP's modem, is jarringly inconsistent with the actual flow of information.

Some CLECs have seized on the following sentence in the D.C. Circuit's opinion: "Calls to ISPs appear to fit this definition: the traffic is switched by the LEC whose customer is the ISP and then delivered to the ISP, which is clearly the 'called party.'" *Bell Atlantic*, 206 F.3d at 6. Read in context, however, this sentence is best understood to characterize MCI WorldCom's argument before the court, not to express the court's own view. The sentence appears at the end of a paragraph whose sole function in the opinion is to describe MCI WorldCom's contentions. That function is made clear by the paragraph's opening sentence, which begins: "In attacking the Commission's classification of ISP-bound calls as non-local for purposes of reciprocal compensation, MCI WorldCom notes . . . ." *Id.*

In any event, the court obviously did not hold that Internet-bound traffic terminates at the ISP. To the contrary, the court remanded the case to the FCC to give the agency an opportunity to explain why such traffic does *not* terminate at the ISP. It is therefore open to the FCC to explain its conclusion that the Internet site, not the ISP, is the "called party," a conclusion that it did not articulate in the *ISP Declaratory Ruling* and did not argue in its brief before the court of appeals.

II. Treatment of ISP-Bound Traffic as "Local" for Reciprocal-Compensation Purposes Would Be Inconsistent With Commission Policy

The D.C. Circuit found that the FCC's prior decisions dictating that the jurisdictional nature of communications must be determined on an end-to-end basis did not adequately support the FCC's determination that Internet-bound calls do not terminate at the ISP's premises. The court identified two problems with the FCC's analysis. First, the court found that the FCC's prior analysis "involved a single continuous communication, originated by an end-user, switched by a long-distance communications carrier, and eventually delivered to its destination." *Bell Atlantic*, 206 F.3d at 6. Second, the court stated that "[e]ven if the difference between ISPs and traditional long-distance carriers is irrelevant for jurisdictional purposes, it appears

relevant for purposes of reciprocal compensation." *Id.* at 6-7. The Commission should resolve both concerns.

A. The FCC's End-to-End Analysis Clearly Applies

As an initial matter, the Commission should make clear that the Commission's end-to-end jurisdictional analysis *has* been consistently applied to circumstances involving multiple service providers, including information-service providers.[5] One illustration of this point not discussed in the court's decision arose out of the Commission's assertion of jurisdiction over "channel service," a common carrier activity involving the leasing of transmission capacity to cable operators for the local delivery of broadcast programming — an information service. AT&T argued that the FCC lacked jurisdiction because the provision of channel service was purely local: "television signals selected and furnished by the CATV operator are locally distributed by the telephone company from the CATV operator's antenna site and control house to terminals at the home viewer's premises — all within 1 community located within 1 State." Memorandum Opinion and Order, *Commission Order, Dated April 6, 1966, Requiring Common Carriers To File Tariffs With Commission for Local Distribution Channels Furnished for Use in CATV Systems*, 4 F.C.C.2d 257, 257, ¶ 4 (1966). The Commission rejected AT&T's argument, holding that cable service was inherently interstate in nature and that channel service was an indivisible part of this interstate service. *Id.* at 259, ¶ 10. This assertion of jurisdiction was later affirmed by the court of appeals. *General Tel. Co. v. FCC*, 413 F.2d 390 (D.C. Cir.), *cert. denied*, 396 U.S. 888 (1969). The court's analysis could just as well have been written in the context of the Internet:

> The stream of communication is essentially uninterrupted and properly indivisible. To categorize [the local telephone company's] activities as intrastate would disregard the character of the television industry, and serve merely to prevent the national regulation that is not only appropriate but essential to the efficient use of radio facilities. . . .
>
> . . . Any other determination would tend to fragment the regulation of a communications activity which cannot be regulated on any realistic basis except by a central authority; fifty states and myriad local authorities

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[5] The Commission cited many of these decisions in its original *ISP Declaratory Ruling*. *See* 14 FCC Rcd 3689, 3695-97, ¶¶ 10-12. *See also Western Union Tel. Co. v. Foster & McCleod*, 247 U.S. 105, 113 (1918) (wire communication continued "until it reached the point where the parties originally intended that the movement should finally end") (internal quotation marks omitted).

> cannot effectively deal with bits and pieces of what is really a unified system of communication.

Id. at 401 (citation and internal quotation marks omitted). Television broadcast is not a common carrier service and the local telephone company's common carrier service was physically located within a single state. But neither the Commission nor the court accepted the attempt to split the service into two: the communication was treated on an end-to-end basis.

In addition, the end-to-end analysis has not been confined to purely jurisdictional analysis, but has been applied as well to substantive questions concerning application of the Commission's rules. The *Teleconnect*[6] case demonstrates that fact — something that the court overlooked. The Commission in that case rejected the argument that a credit card call should be treated, *for purposes of assessing access charges*, as a call from the card user to an interexchange carrier followed by a second call. *See* 6 FCC Rcd at 5206, ¶¶ 21-24. As the Commission held, "courts and this Commission have consistently emphasized that they consider the end-to-end nature of communications rather than the various facilities used . . . . Interstate wire communication is regulated from its inception to its completion by the Communications Act and, within the meaning of the Act, does not end at an intermediate switch." *Id.* ¶ 23.

The Commission's end-to-end analysis in that case had nothing to do with *jurisdiction*, but rather concerned identifying the point at which an indisputably interstate communication terminated for purposes of the substantive application of the FCC's rules. 10 FCC Rcd at 1629-30, ¶ 12 ("While [defendants] attempt to distinguish the so-called 'jurisdictional' nature of a call from its status for 'billing' purposes, they present no persuasive argument nor any authority to support their contention that this distinction has any legal significance."). The Commission has repeatedly reaffirmed that analysis. *See, e.g.*, Memorandum Opinion and Order, *International Telecharge, Inc. v. Southwestern Bell Tel. Co.*, 11 FCC Rcd 10061, 10069-70, ¶ 21 (1996); Memorandum Opinion and Order, *AT&T Corp. v. Bell Atlantic-Pennsylvania*, 14 FCC Rcd 556, 578-79, ¶ 47 (1998) ("Although the LECs and even the IXCs treat the forwarded part of the call as a local or intraLATA toll call for bookkeeping and billing purposes, call forwarding is jurisdictionally mixed, so that both interstate and local charges may apply on the forwarded part of an interstate, interexchange call.").

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[6] Memorandum Opinion and Order, *Teleconnect Co. v. Bell Tel. Co.*, 6 FCC Rcd 5202, 5206 (1991), *recon.*, 10 FCC Rcd 1626 (1995).

Moreover, the FCC has reaffirmed both the jurisdictional and the substantive aspects of this analysis in two recent orders in the specific context of Internet-bound communications. First, in the *GTE Tariff Order*, the Commission found that digital-subscriber-line service connecting a subscriber with an ISP, used to access interstate websites, is properly tariffed in the interstate jurisdiction. 13 FCC Rcd at 22476, ¶ 19. Second, in the *Advanced Services Remand Order*,[7] the Commission determined that whether a digital subscriber line service can be classified as "exchange access" or "telephone exchange service" also depends on the end-to-end nature of the communication. 15 FCC Rcd at 391-92, ¶ 16. In particular, because "telephone exchange service" is defined as "service within a telephone exchange" or "comparable service," the Commission determined that, when a digital subscriber line is used to gain access to a distant website through an ISP, the service cannot qualify as "telephone exchange service" because "ISP-bound traffic does not originate and terminate within an exchange." *Id.*

B. The ESP Exemption Supports the FCC's Determination

The D.C. Circuit viewed the FCC's prior treatment of ESPs as "something of an embarrassment" to the Commission's reciprocal compensation ruling. *Bell Atlantic*, 206 F.3d at 8. It need not be. A focus of the Commission's decision on remand should be to explain that the ESP exemption firmly supports the FCC's prior decision as a matter of policy.

As the D.C. Circuit recognized, two models are potentially applicable to the arrangements at issue in this case. The first is the situation where two local exchange carriers combine to complete a local call; the second is where two local exchange carriers jointly provide access to the local exchange to a user of exchange access. *Id.* at 5.

As a legal matter, there is no question that the latter model, not the former, applies here. Delivery of traffic to ISPs for transmittal to out-of-state websites is an interstate access service. Accordingly, when two local exchange carriers jointly provide the link between the end-user customer and the interstate information service provider, they are engaged in the joint provision of access. They have collaborated not to complete a *local* call, but instead to provide the initial leg of an interstate call.

It might be objected that, although the service provided to ISPs is "legally" interstate access service, "functionally" the FCC has treated the service as though it were

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[7] Order on Remand, *Deployment of Wireline Services Offering Advanced Telecommunications Capability*, 15 FCC Rcd 385 (1999).

local service — that is, it has permitted ESPs to purchase service from local business tariffs. But this argument misconstrues the nature of the ESP exemption: just because calls to ESPs are treated as though they were local for one purpose — that is, for regulating the rate that ESPs and their end users pay for those calls — it does not follow that such calls should be treated as local for all purposes. Specifically, it does not follow that such calls should be treated as local for purposes of inter-carrier compensation. To the contrary, as a matter both of theory and of practice, treating Internet-bound calls as if they were local for reciprocal compensation purposes leads to market distortions and suppresses competition.

The ESP exemption is based on the recognition that ESPs use the local exchange in a manner analogous to the way IXCs use the local exchange — that is, it provides ESPs with a link to their customers in order to provide interstate communications. Thus, an ISP's subscriber — just like an IXC's customer — initiates interstate telecommunications; the information service *rides on top of* that continuous telecommunication. Indeed, the Act defines "information service" as one that is provided "*via telecommunications*." 47 U.S.C. § 153(20) (emphasis added). As the Commission has made clear in prior orders, among the services that ISPs provide to their subscribers is "data transport" — for example, "the movement of information between customers' own computers and distant computers with which those customers seek to interact." *Universal Service Report*,[8] 13 FCC Rcd at 11539, ¶ 80. That data transport is unquestionably provided via telecommunications. *See id.* at 11540, ¶ 81 ("in order to provide those components of Internet access services that involve information transport, [ISPs] . . . acquire telecommunications"). The additional enhancements — "data processing, information provision, and other computer-mediated offerings" — create the information service rather than pure telecommunications. *Id.* But "a service would not satisfy the definition of 'information service' unless it had an underlying 'telecommunications' component." *Advanced Services Remand Order*, 15 FCC Rcd at 401, ¶ 34 n.76.

For this reason, applying the "local call" model — that is, treating an ISP as though it were an ordinary business subscriber for inter-carrier compensation purposes — is inappropriate, because an ISP simply does not use the network in a way that is comparable to ordinary business end users. For example, the D.C. Circuit questioned whether an ISP was any different from "pizza delivery firms, travel reservation agencies, . . . or taxicab companies." *Bell Atlantic*, 206 F.3d at 6 (citation omitted). But none of these firms are information service providers who deliver an interstate information service *via telecommunications*. Rather, they are local business subscribers, who engage in local

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[8] Report to Congress, *Federal-State Joint Board on Universal Service*, 13 FCC Rcd 11501 (1998).

communications with customers and potential customers over the telephone. A pizza parlor's telephone number is available to all subscribers to the local exchange. No pizza parlor delivers a pizza over the phone lines, and nothing in the contract between the pizza parlor and the customer involves the use of the local network. The same is true for travel agencies and taxicab firms.

As for credit card verification firms — also mentioned by the court — if those firms provide an information service via interstate communications, calls to those firms should be treated in the same manner as calls to ISPs, that is, as interstate access calls, not as local calls. Thus, reciprocal compensation would not apply to them under the Commission's rules. The same is true of a bank information line: if the call is an interstate call, reciprocal compensation does not apply. Indeed, these examples help to prove our point. A bank may provide its subscribers with an 800 number for retrieving account information; alternatively, the bank may use locally dialed numbers and a private line for interLATA transport. In either case, the local exchange carrier or carriers provide the same function — exchange access — and it makes no economic sense to apply reciprocal compensation in the latter case.

Paying reciprocal compensation for ISP-bound calls — in contrast to paying similar compensation for ordinary business calls — therefore shifts the costs of network access in a way that is both inefficient and unfair. The usage-sensitive costs of ISP-bound traffic are caused by ISPs and their subscribers. Most subscribers to the local exchange have no ability to connect to the ISP's access numbers, which are provided only to its own paying customers and which are password protected. Moreover, the local exchange carrier generally receives no incremental revenues from the caller to cover the costs of the calls going to the ISP. If the originating local exchange carrier is required to pay reciprocal compensation to a CLEC providing service to an ISP, the usage-sensitive costs of the service that the ISP uses will be spread among all subscribers to the local exchange, even though most subscribers do not use — and have no right to use — the service.

Payment of reciprocal compensation on such traffic also has the pernicious effect of encouraging the misallocation of investment and discouraging the development of residential telephone competition. In many states, the imbalance of traffic generated on ILECs' networks compared to the traffic generated on CLECs' networks is running at a ratio of more than 10:1. The imbalance is due almost entirely to Internet-bound traffic. This statistic provides a vivid illustration of the incentive that application of reciprocal compensation to Internet-bound traffic has created for CLECs to devote investment resources to this niche market while neglecting many other markets entirely. Moreover, applying reciprocal compensation to such traffic affirmatively discourages CLECs from competing for residential customers. Once a CLEC has won an ISP customer, each

residential customer that continues to be served by an ILEC is a potentially valuable source of reciprocal compensation revenue for the CLEC. That revenue is likely to exceed by several times the amount of revenue the CLEC could expect to charge the same residential customer if the CLEC were its local exchange provider. Residential customers are thus far more valuable to a CLEC if they remain customers of the incumbent LEC than if they become the CLEC's own customers.

But that is not all. If the CLEC were able to attract a residential customer as a subscriber of its local exchange customer, the customer might choose an ISP served by a *different* CLEC. In that event, the residential customer may become a *liability* for the serving CLEC, because the CLEC serving the customer's ISP might then demand reciprocal compensation payments for Internet-bound traffic generated by the customer. Nothing in the statute, the Commission's rules, or common sense supports that paradoxical and counterproductive result.

Indeed, the problem is even worse where the reciprocal compensation exceeds a strict measure of the CLECs' costs. In that situation, CLECs actually have an incentive to arrange for ILEC customers to generate traffic headed for CLECs' networks simply for purposes of generating the above-cost reciprocal compensation payments.[9] But even if the reciprocal compensation rate is set closer to the CLECs' usage-sensitive costs, the anti-competitive effect remains. For example, at a compensation rate of $.001 per minute — lower than that established so far in states where compensation is required — a residential customer can generate up to $43.20 per month in reciprocal compensation. That amount far exceeds the residential rate, including all federal line charges.[10]

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[9] This is exactly what happened in the case of one scam recently uncovered by the North Carolina Utilities Commission. A competitive local exchange carrier had billed BellSouth over $100 million in reciprocal compensation. As it turned out, the CLEC had deliberately generated the traffic by paying for customers to receive service out of all proportion to the customer's needs. For example, the CLEC paid for the installation of a router and four primary rate ISDN lines at Charlie Horse Farm in order to establish 92 virtually continuous connections to the Internet. *See* Order Denying Reciprocal Compensation, *BellSouth Telecomms., Inc. v. US LEC of North Carolina, Inc.*, Docket No. P-561, Sub 10 (N.C. Utils. Comm'n Mar. 31, 2000).

[10] It is true that other customers with high volumes of incoming calls might prove attractive to CLECs because of the reciprocal compensation charges they would generate, particularly if reciprocal compensation is set (erroneously) above cost. But other business end users do not pose the same type of practical policy problem for regulators. As an initial matter, the volumes of traffic that such customers can generate is nowhere near what ISPs have generated. ISP traffic is growing at an explosive rate. And Internet-bound calls are far longer than conventional voice calls: while the average voice call lasts something like three minutes, the

The implications of these facts for the FCC's pending rulemaking on inter-carrier compensation for ISP-bound traffic is a matter that has been discussed (and will be discussed further) in separate individual submissions. But the Commission should nevertheless articulate the policy rationale for its determination that ISP-bound traffic is outside the scope of its current rules.

In sum, to address the Court's concerns, the Commission should make clear that the ESP exemption does not support the proposition that interstate information service providers should be treated the same as any other business customer for purposes of inter-carrier compensation. To the contrary, the payment of reciprocal compensation for such traffic spreads costs in a manner that is inefficient and unfair, discourages efficient investment and the development of local competition, and risks additional market distortions.

III. Whether Internet-Bound Traffic Is "Telephone Exchange Service" Is Irrelevant to This Proceeding, But, in Any Event, Internet-Bound Traffic Is Not "Telephone Exchange Service"

The D.C. Circuit found that there was an "independent ground requiring remand" in the *Bell Atlantic* case: namely, the Commission's failure adequately to address MCI's argument that "ISP-traffic is 'telephone exchange service[]' as defined in 47 U.S.C. § 153(16) . . . and emphatically not 'exchange access' as defined in 47 U.S.C. § 153(47)." *Bell Atlantic*, 206 F.3d at 8. MCI argued that telephone exchange service "is synonymous under the Act with the service used to make local phone calls." *Id.* As the court noted, the Commission was hobbled by its prior rulings that "telephone exchange service" and "exchange access" are "the only possibilities" and that "'ISPs do not use exchange access.'" *Id.* (citation omitted). Although the court recognized that the Commission had overruled the latter determination after oral argument, it refused to take that subsequent decision into account because the agency did not articulate that judgment "in the ruling under review." *Id.* at 8-9.

The court also acknowledged that "[t]he statute appears ambiguous as to whether calls to ISPs fit within 'exchange access' or 'telephone exchange service,' and on that view any agency interpretation would be subject to judicial deference." *Id.* at 9. But because the FCC had not yet properly articulated an interpretation, the court concluded that it could not defer to a vacuum: "[E]ven though we review the agency's interpretation

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average Internet-bound call is about ten times that long. Accordingly, it is easy for CLECs to isolate this traffic and harvest the reciprocal compensation revenues — and that is precisely what they have done.

only for reasonableness where Congress has not resolved the issue, where a decision 'is valid only as a determination of policy or judgment which the agency alone is authorized to make and which it has not made, a judicial judgment cannot be made to do service.'" *See id.* (quoting *SEC v. Chenery Corp.*, 318 U.S. 80, 88 (1943).

As an initial matter, the Commission should make clear on remand that, under its rules, the question whether Internet-bound traffic is telephone exchange service, exchange access, or something else is simply irrelevant to the question whether reciprocal compensation applies. As noted above, the reciprocal-compensation issue turns, under the Commission's rules, solely on whether the traffic in question is "local telecommunications traffic" — that is, whether it "originates and terminates within a local service area." *See* 47 C.F.R. § 51.701(b)(1). Those rules make no reference to the Act's definitions of "telephone exchange service" and "exchange access," and there is no reason to import these definitions into the rules.

In any event, the FCC has correctly determined, to the extent that the issue has any relevance here, that Internet-bound traffic does not qualify as "telephone exchange service" under the Act. In the *Advanced Services Remand Order*, the FCC found that "[t]he primary distinction between [telephone exchange service and exchange access] is that, while telephone exchange services permit communication 'within a telephone exchange' or 'within a connected system of telephone exchanges within the same exchange area,' exchange access refers to access to telephone exchange services or facilities for the purpose of originating or terminating communications that travel outside an exchange." 15 FCC Rcd at 391, ¶ 15 (footnote omitted). Because "typically ISP-bound traffic does not originate and terminate within an exchange," such traffic "does not constitute telephone exchange service within the meaning of the Act." *Id.* at 391-92, ¶ 16.

On remand in the present case, the Commission should make clear that it adheres to and applies that definitive interpretation.

CONCLUSION

The Commission should promptly reaffirm its prior determination that Internet-bound calls are not subject to reciprocal compensation under the Act and the Commission's rules.

July 21, 2000